BDC
Entrepreneurs first

economic LETTER

SEPTEMBER 2015

LINK BETWEEN THE PRICES OF CRUDE OIL AND GASOLINE

The global market price for crude oil is almost half of what it was a year ago, yet the price Canadians pay at the pump has not fallen by the same amount. Why? This can be explained by the fact that the price of gasoline reflects movement in each of its components, which are as follows:

- Crude oil prices, expressed in Canadian dollars;
- The gross margin for refining, meaning the cost to transform crude oil into gasoline, including the refiner's profit margin;
- The retailer's gross margin, meaning the operating cost of gas stations, including the retailer's profit margin;
- Taxes (federal, provincial and other).

In Canadian dollars, the decrease in crude oil prices was not as pronounced

Globally, the price for a barrel of crude oil is set in U.S. dollars. The decrease in crude oil prices since July 2014 was accompanied by a depreciation in the Canadian dollar against the U.S. dollar. In fact, this depreciation stems largely from plummeting oil prices, in light of its expected negative impact on the Canadian economy. The depreciation of the Canadian dollar translated into an increase in crude oil prices for Canadian refineries. Consequently, the price of their input did not fall as much as it did on the global market. The price of Brent crude, for example, one of the varieties of oil imported by refineries in Quebec and Eastern Canada, dropped 47% between July 2014 and July 2015 on the global market (in U.S. dollars), while falling only 36% in Canada during the same period (in Canadian dollars). Similarly, the price decrease for Western Canadian Select, one of the blends used by refineries in the west, was not as sharp in Canadian dollars as it was in U.S. dollars (44% compared with 53%).

Gross margins have risen recently

As demonstrated in Graph 1, gross margins for refineries and retailers have risen considerably. In July 2015, they reached 38.5 cents, while they were 23.5 cents a year earlier, representing an increase of 15 cents. It seems that the increase stems mainly from higher refinery gross margins, which rose close to 10 cents in the last 12 months[1]. Even though there is a clear gradual progression by gross margins over the last year, they have especially risen since June. ▼

1 Fuel Focus, July 24, 2015, Natural Resources Canada, page 4.

Canada

- GDP fell for the second consecutive quarter
- Employment advanced slightly
- Exports are picking up steam
- Housing starts tumble

United States

- GDP growth accelerates
- The unemployment rate falls again
- Housing starts and residential sales are up

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BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to September 5. Reliance on and use of this information is the reader's responsibility.

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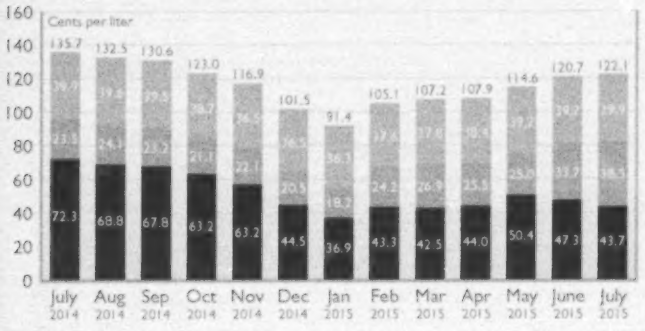
Graph I: Taxes stayed relatively stable while margins rose

Price of regular gas at the pump by components, 4-week moving average, July 2014 to July 2015



Sources: various publication of Fuel Focus Bulletin, Natural Resources Canada

Taxes on gasoline held fairly steady

Most of the taxes on gasoline are excise taxes, which mean they are based on the amount purchased, not on the value. Yet, changing gasoline prices, whether rising or falling, have a limited impact on consumption. Graph 1 demonstrates that the amount of taxes has been fairly stable since July 2014, ranging from 36.3 cents to 39.9 cents per litre, despite the sharp drop in crude oil prices.

Because they represent a significant portion of the retail price of gasoline (33% of the price at the pump in July 2015, on average nationally), taxes are a major impediment to prices going down.

Consequences for the Canadian economy

All these factors – depreciating Canadian dollar, increasing gross margins and the role of taxes – have limited the impact falling crude oil prices have had on gasoline prices. Canadian businesses and households have still saved on fuel since the middle of 2014. A portion of this savings was no doubt used to purchase other goods and services, which contributed to offsetting the negative effect of oil prices on the Canadian economy. ■

CANADA

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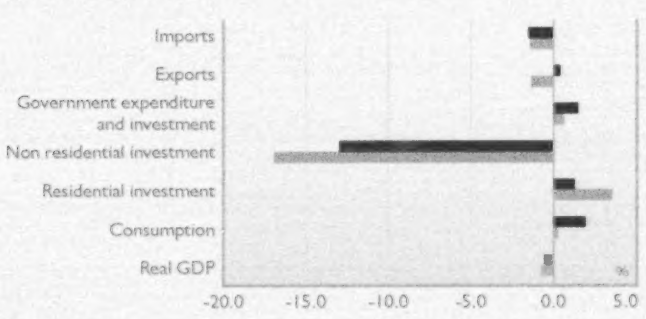
Applying the strict definition of a recession as two consecutive quarters of falling GDP, Canada entered into a recession in the first half of 2015. However, the decrease in GDP was weak, and other economic indicators are not showing declines as sharp as generally seen in a recession. On the contrary, the most recent economic data suggest that the economy has already started to pick up steam.

GDP fell for the second consecutive quarter

After falling 0.8% in the first quarter, real GDP slipped 0.5% in the second quarter. The contraction in real GDP during the first half of 2015 is almost entirely attributable to the decrease in non-residential investment (graph). Economic accounts data do not provide details on investment by industry, but it seems clear that investment will have fallen off in the industries most impacted by plummeting crude prices, starting with oil extraction. With a second consecutive quarterly decrease in real GDP, Canada was technically in a recession in the first part of the year. However, most other economic indicators (employment, retail sales, exports and imports), are not indicating a sharp pullback in economic activity. In addition, data for GDP by industry indicate a rebound in growth in June, following five straight months of decline. Consequently, everything suggests that the economy will pick up steam in the coming months.

The fall in real GDP is due to declining non-residential investment

Annualized quarterly growth of real GDP and its main components, Q1 2015 and Q2 2015



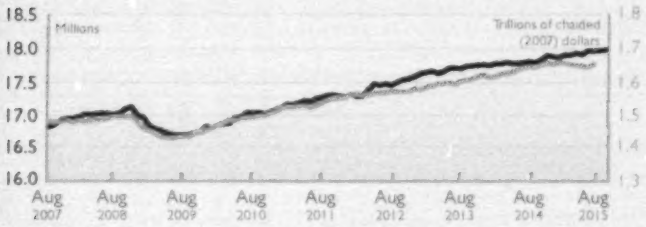
Source: Statistics Canada

Employment advanced slightly

Jobs rose by 12,000 in August, following a gain of 6,600 the previous month. The unemployment rate edged up 0.2 percentage points to 7.0% due to the increase in the number of people seeking work. Since the start of 2015, the average monthly change in employment rose to 14,300 compared with 8,400 in 2014. Contrary to what happened in the recession of 2009, employment has not fall recently, despite the drop in real GDP (graph). Of course, real GDP's recent slide remains weak compared to the Great Recession. ▼

The pullback in GDP is much weaker than in 2009, and employment has not fallen recently

Employment, August 2007 to August 2015; GDP by industry, August 2007 to June 2015



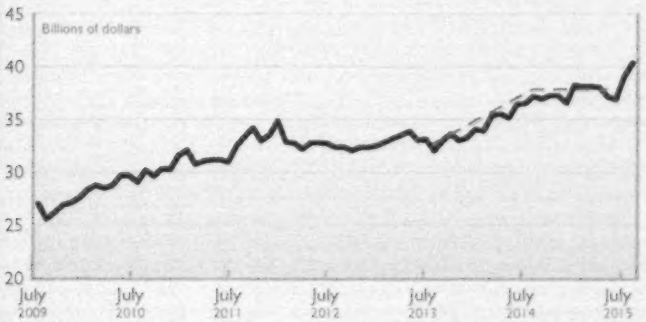
Source: Statistics Canada

Exports are picking up steam

Following several months of declines due to falling crude oil prices, exports bounced back in June and July, posting monthly growth of 5.5% and 2.3%, respectively. Excluding crude oil, exports, which grew strongly from July 2013 to July 2014, had stagnated for almost a year by the time they rebounded in June 2015 (graph). During the last two months, exports were up in all the major product categories, aside from energy products and metal ores and non-metallic minerals. These results suggest that the Canadian economy has already picked up steam after the weakness observed in the first half.

Exports excluding crude oil have rebounded strongly since June

Value of exports, excluding crude oil, July 2009 to July 2015



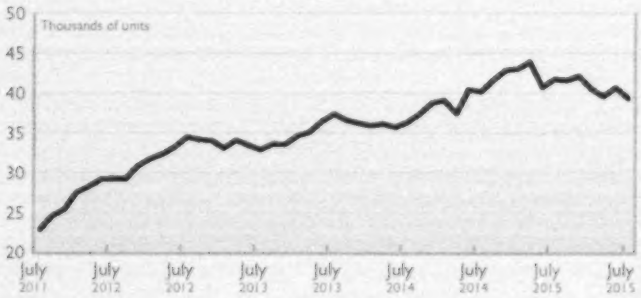
Source: Statistics Canada

Housing starts tumble

Housing starts fell by 5.9% in urban centres in July: starts for multi-unit dwellings fell 8.2% and starts for single-family homes slipped 0.8%. Nationally, the housing starts trend, measured using the six-month moving average, has remained fairly stable of late. Regionally, however, the trend is down in some provinces, particularly in Alberta (graph). After years at full tilt, residential construction activity has slowed in that province since the end of 2014, due to the negative impact of falling crude oil prices on the economy. ■

Housing starts are trending down in Alberta

Six-month moving average, July 2011 to July 2015



Source: Statistics Canada

★ UNITED STATES

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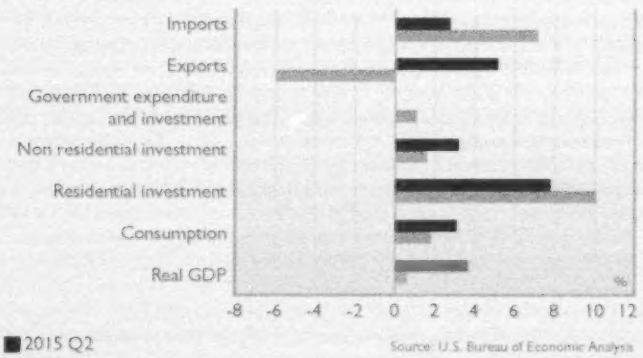
GDP rebounded strongly in the second quarter, which seems to confirm that the weakness observed in the first quarter stemmed largely from bad weather. Solid advances in jobs, a falling unemployment rate and increased activity in the housing market suggest that economic growth continues to be robust.

GDP growth accelerates

Following an increase of only 0.6% in the first quarter of 2015, real GDP advanced 3.7% in the second quarter (based on the U.S. Department of Commerce Bureau of Economic Analysis's 2nd estimate). Not including residential construction, where growth slowed slightly, all the components of real GDP contributed to accelerating growth in the 2nd quarter (graph). For 2015, real GDP was forecast ▼

Real GDP growth accelerated in the second quarter

Annualized quarterly growth of real GDP and its main components, Q1 2015 and Q2 2015



Source: U.S. Bureau of Economic Analysis

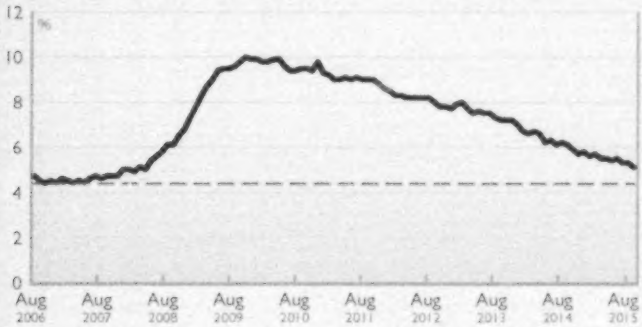
to grow at 2.3% before these results were released (Consensus of August 10, 2015). They could be revised upward a few decimal points in the coming months if economic indicators stay positive.

The unemployment rate falls again

Non-farm employment was up 173,000 in August, representing a somewhat more modest monthly advance than the average of 218,000 observed in the first seven months of the year. The unemployment rate slipped 0.2 percentage points to 5.1% in August, its lowest level since March 2008 (graph). The recovery of the labour market after the Great Recession was slow, but it appears to be returning to normal.

The unemployment rate is almost back to pre-Great Recession levels

Unemployment rate, August 2006 to August 2015



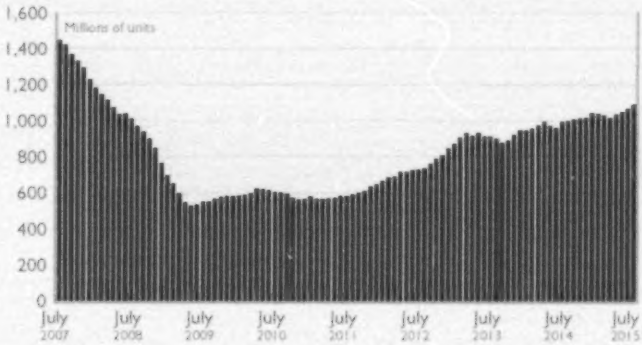
Source: U.S. Bureau of Labor Statistics

Housing starts and sales are up

Housing starts, which had recorded a decrease in the first quarter of the year, likely due to poor weather conditions, regained their upward trend in April (graph). Existing home sales increased 2.0% in July to their highest level since February 2007. According to the president of the U.S. National Association of Realtors, the possibility that mortgage rates increase in the near future and that home prices continue to grow in the coming months encouraged many consumers to bring forward the timing of their home purchase. ■

Housing starts are trending up again

Six-month moving average, July 2007 to July 2015



Source: U.S. Census Bureau

INTEREST RATES

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The key rate should remain stable

The Canadian economy was technically in a recession in the first semester of the year and the price of crude oil could end up being much lower than the central bank expected in its projection. Consequently, the Bank of Canada could again decide to lower its target for the overnight rate to stimulate the economy. However, several elements argue for the status quo: given the key rate's current low level (0.50%), the impact of another 25-basis-point reduction could be very limited; the decrease in real Canadian GDP in the first two quarters of 2015 was weak, and the most recent economic indicators suggest that the economy has already started to pick up steam; the U.S. economy has regained some strength and the Canadian dollar depreciated further recently, which should stimulate Canadian exports. Forecasters believe that the central bank will leave rates unchanged at the next monetary policy meeting on September 9. ■

OIL PRICE

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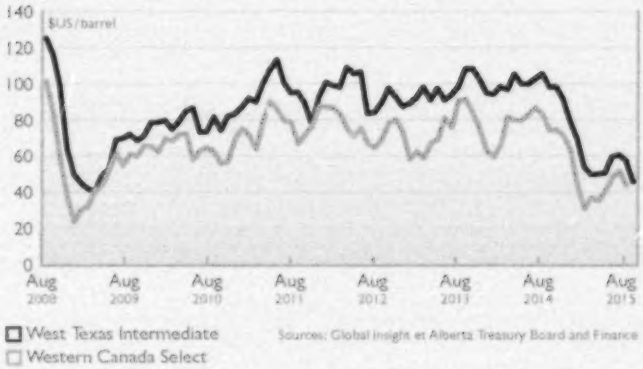
Crude oil is trending down again

After a brief climb in the spring, crude oil prices returned to a downward trend this summer. At $US45 per barrel in August, the price of West Texas Intermediate is 54% lower than it was one year ago. Poor economic results in China, the world's second largest oil consumer, fueled expectations of a global contraction in oil demand. In addition, the global supply continues to be in a surplus, which also puts downward pressure on the price of black gold. ■

Crude oil prices dip again

(August 2008 to August 2015)



Sources: Global Insight et Alberta Treasury Board and Finance

CANADIAN DOLLAR

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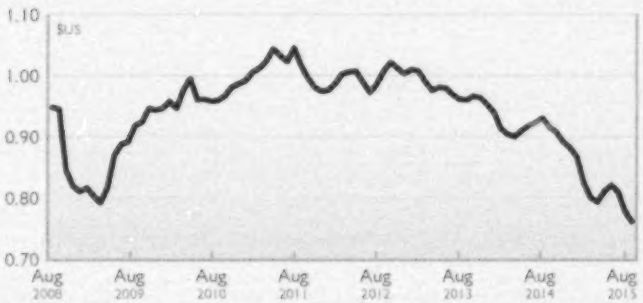
The Canadian dollar depreciates further

The value of the loonie fell 2.1% against the U.S. dollar in August. This depreciation is due to the decrease in crude oil prices and differences between Canadian and U.S. monetary policies. Since the start of the year, the Bank of Canada has reduced the key rate twice in order to stimulate an economy weakened by falling oil prices, and it could intervene again in the coming months. In the United States, after slowing growth in the first quarter, the economy rebounded in the second quarter, firming expectations that the target range for the federal funds rate will be increased by the end of the year. ■

The Canadian dollar continues to depreciate against the U.S. dollar

(Canada/U.S. exchange rate, August 2008 to August 2015)



Source: Bank of Canada

SME CONFIDENCE

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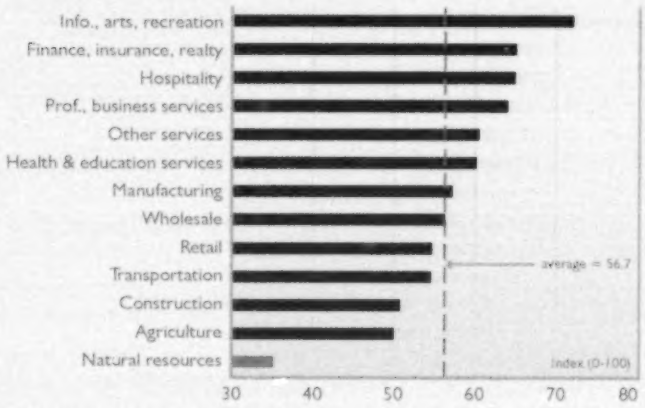
SMEs continue to lose confidence

The Business Barometer Index of the Canadian Federation of Independent Business tumbled 1.6 points to 56.7 in August, its weakest level since April 2009. The decline in August is fairly widespread: the index fell in eight of the thirteen sectors comprising it, and in seven of the ten Canadian provinces. With falling oil prices, it is unsurprising that the confidence of SME owners in the natural resources sector was at its lowest in August (graph). Entrepreneur confidence is also weak in construction and transportation, sectors likely to suffer from the aftermath of slowing activity in the oil sector. Lastly, in retailing and wholesaling, falling confidence is no doubt attributable to weakness in the Canadian dollar, which risks lowering profit margins for retailers who import. ■

Confidence is lowest in the natural resources sector

Business barometer by sector, August 2015



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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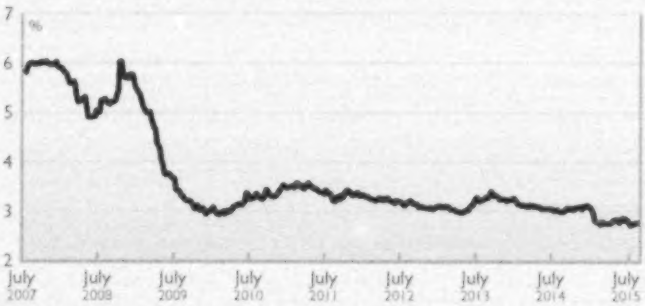
Bank credit advances at a good pace

Credit granted to businesses by chartered banks rose 1.3% in July over the previous month and 13.7% over July 2014. Businesses are enjoying very good credit conditions. The Bank of Canada's 25-basis-point reduction in the key rate in January and again in July certainly contributed to keeping the effective interest rate for businesses (a weighted average of various bank interest rates and market interest rates, for new lending to non-financial businesses) at a historic low (graph). ■

The effective interest rate for business still very low

Weekly data, July 13, 2007 to August 21, 2015



Source: Bank of Canada

KEY INDICATORS—CANADA

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Key indicators—Canada

	Historical[1]				2015[2]				2015		Forecast	
	2011	2012	*2013	2014	Q1	Q2	Q3	Q4	Latest[3]		2015	2016
Real GDP (% growth)	3.0	1.9	2.0	2.4	-0.8	-0.5			Jun	0.5	1.1	2.1
Machinery and Equipment Expenditures (% growth)	8.1	1.9	1.0	1.0	-6.2	-17.1					-3.6	1.8
Pre-Tax Corporate Profits (% growth)	23.3	-6.7	0.7	10.8	-48.5	6.8					-10.6	7.6
Industrial Production (% growth)	4.1	1.4	1.8	4.1	-4.4	-9.6			Jun	1.4	-1.5	1.7
Industrial Product Prices (% growth)	6.9	1.1	0.4	2.5	-0.4	1.7			Jul	0.7	-1.0	2.4
Non-Residential Construction (% growth)	15.9	13.5	5.0	-0.1	-23.5	-8.8						
Housing Starts (' 000 units)	193	215	188	189	175	193			Jul	193	184	179
Personal Expenditures (% growth)	2.2	1.9	2.5	2.7	0.5	2.3					2.0	2.1
Consumer Price (% growth)	2.9	1.5	1.0	1.9	-0.2	2.5			Jul	0.2	1.2	2.0
Employment (% growth)	1.5	1.3	1.4	0.6	0.7	0.8			Aug	0.1		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	6.7	6.8			Aug	7.0	6.8	6.7
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	61.4	60.2			Aug	56.7		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	61.9	57.8			Aug	57.3		

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.

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